

BELLSOUTH

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October 23, 1996

Ex Parte

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OCT 23 1996

Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Acting Secretary
1919 M Street N.W., Room 222
Federal Communications Commission
Washington, D.C. 20554

RE: Ex Parte Meetings on Universal Service: CC Docket No. 96-45

Dear Mr. Caton:

Today, in separate meetings, representatives of BellSouth met with James Casserly, Senior Legal Advisor to Commissioner Ness, Dan Gonzalez, Legal Advisor to Commissioner Chong and John Nakahata, Special Assistant to Chairman Hundt to discuss BellSouth's position in the above-mentioned proceeding. The attached charts were provided in each meeting as an aid to the discussion. These charts are consistent with BellSouth's position already filed in this proceeding. Representing BellSouth were Ms. M. Henze, Mr. P. Martin, and the undersigned.

This notice is being filed today pursuant to Section 1.1206(a)(2) of the Commission's rules. If you have any questions concerning this filing, please do not hesitate to contact me.

Sincerely,



Maurice P. Talbot, Jr.
Executive Director - Federal Regulatory

Attachment

cc: James Casserly
Daniel Gonzalez
John Nakahata

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Recommendations on Universal Service Funding

October, 1996

BellSouth Telecommunications

Need to Make Implicit Support Explicit

- Telecommunications Act of 1996 requires that universal service support be explicit, sufficient, and sustainable
- Most support today is implicit, and will not be sustainable in a competitive environment
- Need to replace current federal universal service support mechanisms with explicit, sufficient and sustainable mechanism
- A principle of the Telecommunications Act is that there shall be both state and federal mechanisms

Benefits of a Sufficient Universal Service Fund

- *Consumers* benefit because rates remain affordable and companies have an incentive to invest in universal service
- *Facilities based competitors* benefit because the support, which is portable, makes it economic to enter even high cost areas
- *Regulators* benefit because they will have met their legal mandate to ensure support is explicit and sufficient

Universal Service Funding

- Three major components of Interstate fund
 - » Core Fund
 - » Education and Health Care
 - » Low Income

Core Universal Services

- Definition includes voice grade basic local exchange telephone service
 - » Single Party Service with Directory Listing
 - » Touch Tone
 - » Access to Emergency Services
 - » Access to Operator Services
 - » Access to Directory Services
- Total Support calculated on an unseparated basis
- Distinct split made between Interstate and Intrastate components
- Interstate support initially set equal to Interstate CCL including LTS, DEM Weighting, and the current USF Fund

Calculation of Universal Service Support

Step 1: Determine affordability benchmarks

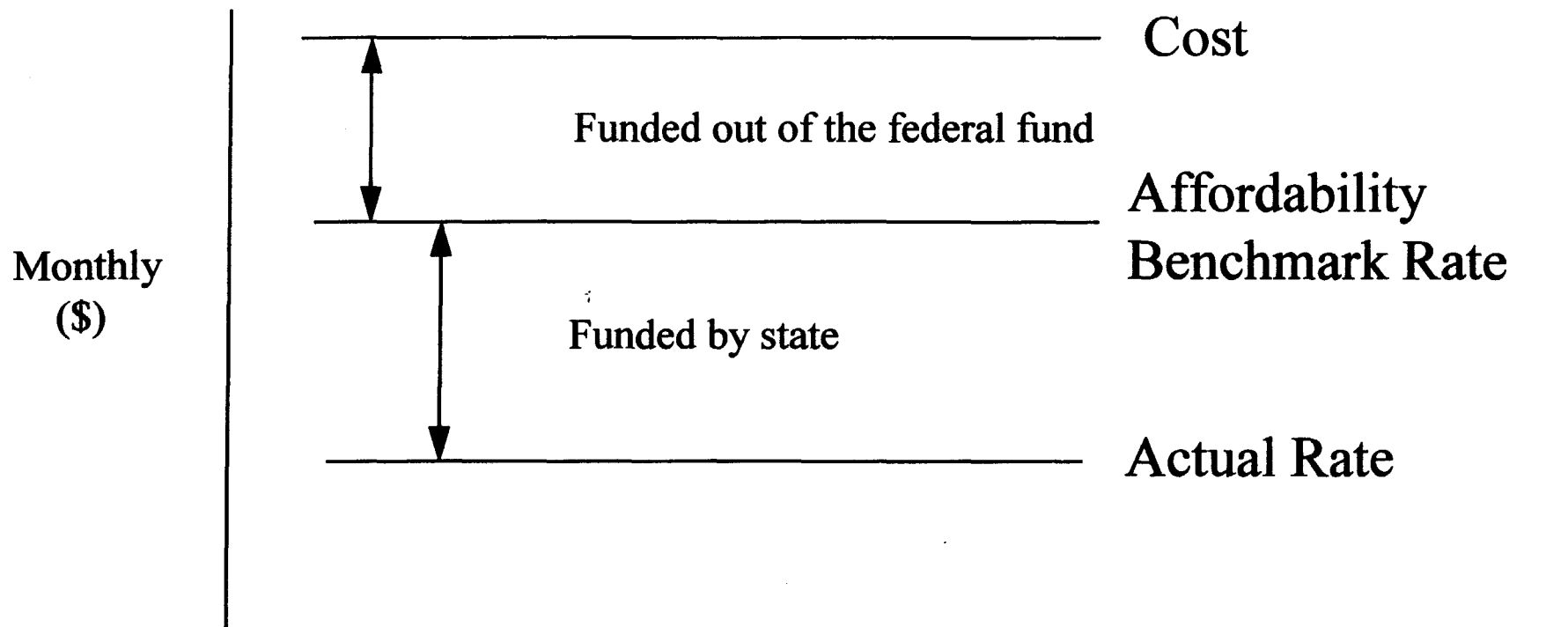
Step 2: Calculate universal service cost per line for small areas

Step 3: Calculate Federal and state support

Step 4: Calculate total support for each company

Step 5: Make rate reductions to remove implicit support and offset initial level of explicit support

UNIVERSAL SERVICE FUNDING GENERAL APPROACH



In this scenario, funding is provided out of the federal universal service fund for the difference between the cost and the affordability benchmark rate. The state is responsible for funding the difference between the affordability benchmark rate and the actual rate. It could accomplish this by establishing an intrastate universal service fund.

Affordability Benchmarks

- Affordability benchmarks should be set based on 1% of county median income
- Floors and ceilings for affordability benchmarks should also be established
- The affordability benchmark acts as a demarcation point between the federal fund and the state fund
- Local rates need not rise to the affordability benchmark; however, state is responsible for funding any shortfall

Universal Service Costing

- Universal service support should be based on fully distributed actual costs
 - » Loop and local switching costs should be included
 - » Share of overhead costs should be included
- Portability of subsidy ensures efficient provision of service
- No proxy model can truly replicate actual costs

Eligibility for Core Universal Service Support

- Carriers must meet certain criteria to be designated as “eligible” for support
 - » offer universal service on a standalone basis throughout a defined serving area
 - » advertise the availability of service throughout serving area using general distribution media
 - » subject to service provisioning rules
 - » the carrier may use its own facilities or a combination of its own facilities and resale
- Support to be provided on a “per line served” basis to any eligible carrier

Contributions to the Fund

- All telecommunications services providers should contribute
- Contributions should be based on end-user revenues
- An end-user surcharge is the most efficient way to collect the assessment
- Companies must have a competitively neutral way to recoup their assessments

Core Universal Service Support - Other issues

- BellSouth proposes that support always go to the facilities based carrier when resale of local exchange service is involved
- State Commissions to determine serving areas
 - » Costs vary between rural and urban areas
 - » Serving areas should reflect cost differences
 - » BellSouth recommends wire centers for determining universal service support if book costs are used
- Auctions for universal service support are subject to considerable gaming and should not be used
- Federal fund could be split into interstate and intrastate components

All Universal Service Support Should be Offset through Rate Reductions Upon Implementation

- Any net support initially received from the interstate component should be offset through interstate switched access rate reductions
- Any net support initially received from the intrastate component should be offset through intrastate rate reductions
- Implementation of Universal Service Support Mechanisms should be done in a revenue neutral manner (on Day 1 only)

Size of Federal Universal Service Fund

- Core federal universal service fund would depend on affordability benchmarks and cost standards
- The interstate component of the core fund would be in the range of \$5-7 billion
- Core fund size could be decreased by up to \$3 billion through SLC increases

The Four Cost Proxy Models Under Consideration

- The original Benchmark Cost Model (BCM)
 - » Sponsored by USWest, Sprint, MCI and NYNEX
 - » MCI used a low annual cost factor, while the other three endorsed a higher ARMIS-based annual cost factor
- The Benchmark Cost Model 2 (BCM2)
 - » Sponsored by USWest and Sprint
 - » Significant changes made to original BCM
- The Cost Proxy Model (CPM)
 - » Developed by Dr. Rick Emmerson (INDETEC) for Pacific Bell
- The Hatfield Model - Version 2.2
 - » Sponsored by AT&T and MCI

The Original BCM is Seriously Flawed and Should Not Be Used

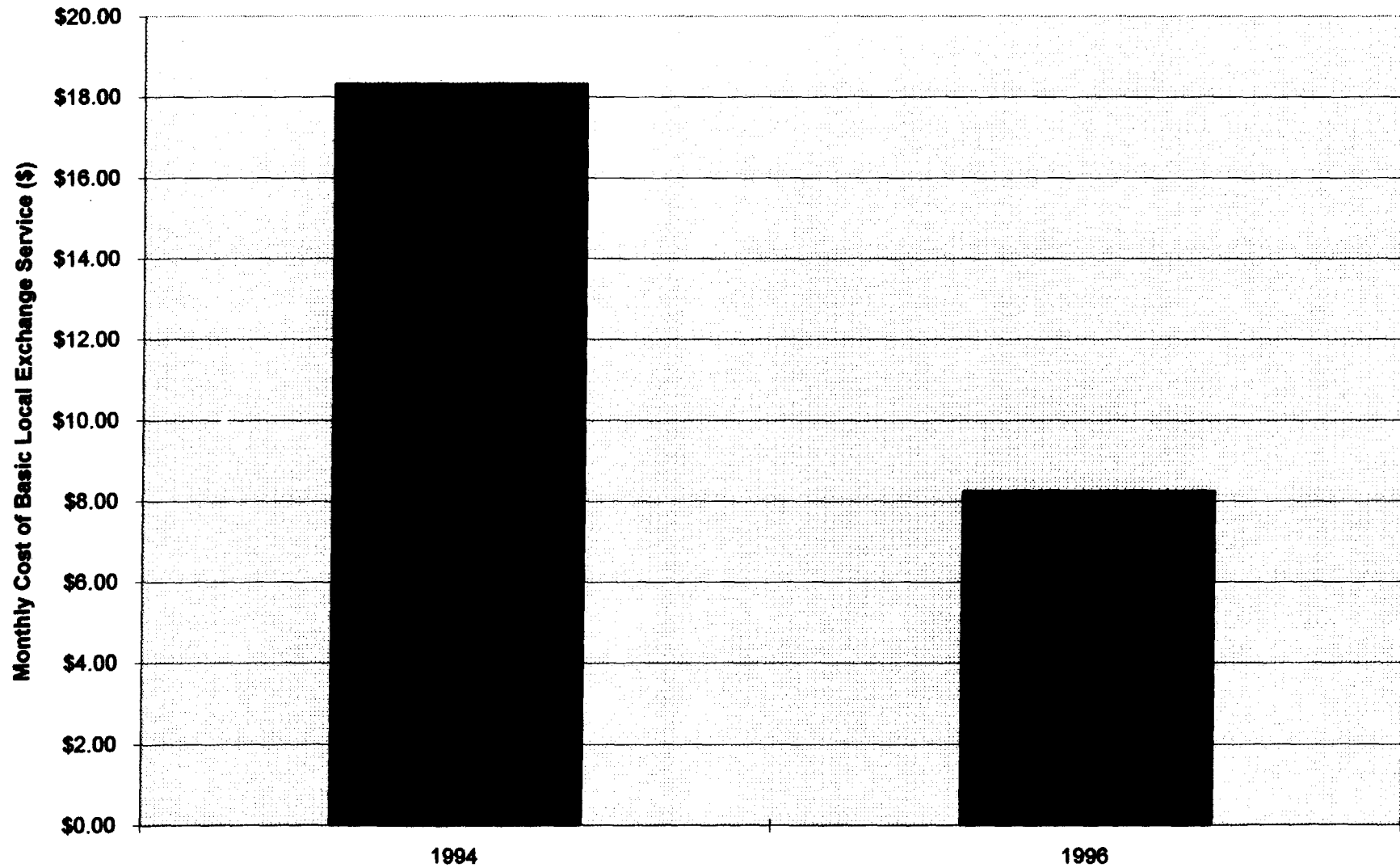
- Criticized by numerous parties including BellSouth
- It overestimates costs in rural areas and underestimates costs in urban areas
- It leaves out drop wire and terminal expense
- All expenses calculated based on a ratio to investment
- Census block groups sometimes assigned to wrong wire centers

The Hatfield Model is Flawed and Should Not Be Used

- The model pulls in part from the flawed Benchmark Cost Model
- Minimal consideration of joint and common costs
- Uses prescribed depreciation lives rather than economic lives
- Uses unrealistic cost of money
- Uses overly high utilization factors
- Underestimates economic cost of service, especially in urban areas
- Erroneously assigns only a small part of trenching costs to telephony
- Endorsed by AT&T and MCI as a pricing tool
- The results have fluctuated greatly over time

COMPARISON OF HATFIELD STUDY RESULTS: 1994 TO 1996

Density Zone: Greater than 5,000 people per square km

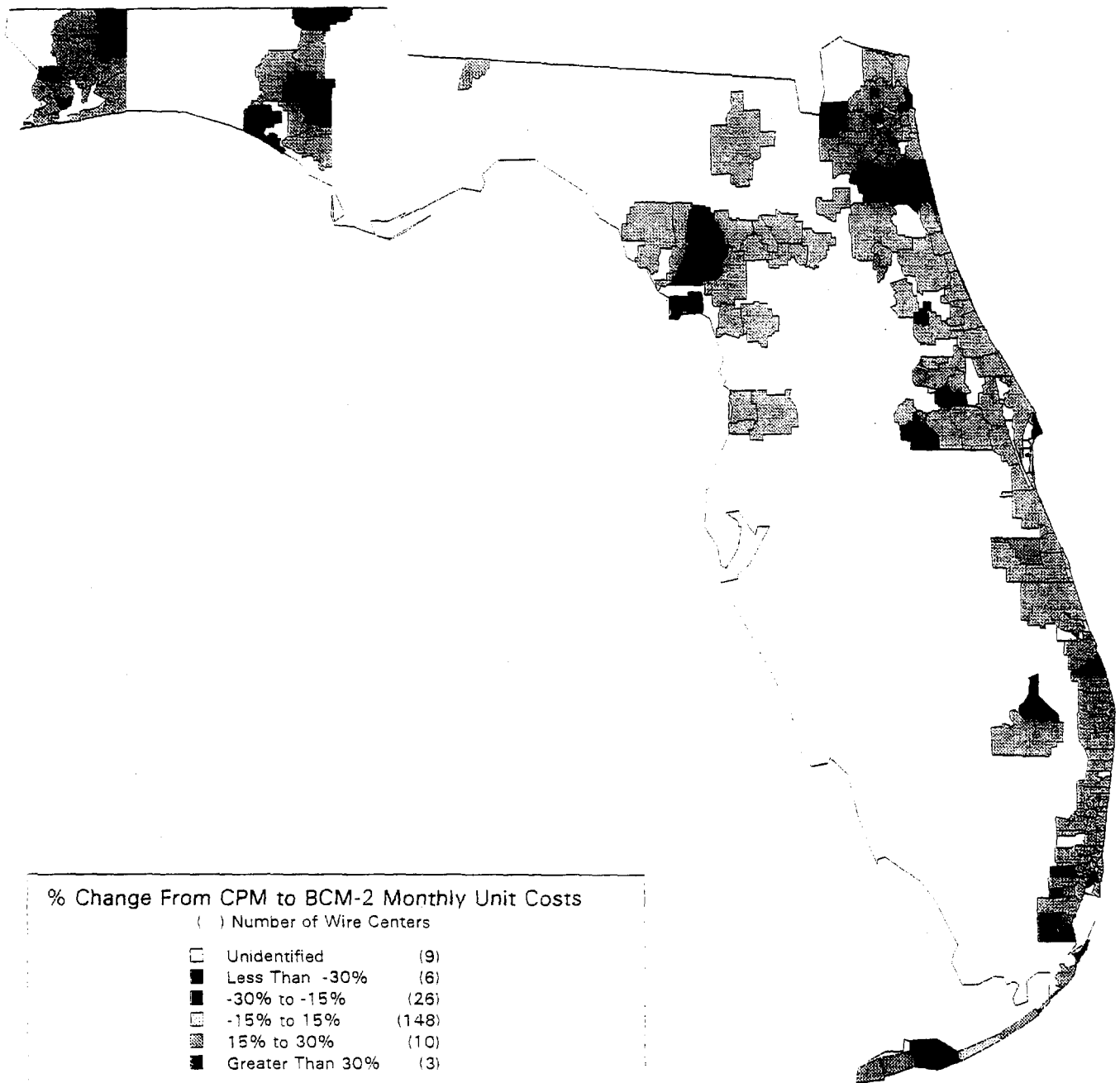


The BCM 2 and the CPM appear to have some Potential for Use in Universal Service Support Calculations

- Both are based on sound engineering criteria
- Both consider some expenses on a per line basis and other expense on an investment basis
- Both use reasonable fill factors
- Both account for a reasonable share of joint and common costs
- Both allow some state specific inputs
- Both include drop wire and terminal investment

Comparison of CPM & BCM-2

BellSouth - Florida Wire Centers



If a Proxy Approach is Adopted, then a Proxy Model that Combines the Best of the CPM and the BCM2 is Needed:

- The best of the CPM and the BCM2 could be combined. For example, one approach would be:
 - » use BCM2 as base
 - » incorporate grid cells rather than CBGs
 - » map grid cells to actual serving wire center rather than closest wire center
 - » use economic depreciation lives
 - » other items to be determined

Education Fund

- BellSouth recommends a flexible discount (Funds-to-Schools, or “FTS”) approach based on universal service funds determined by the KickStart Initiative
 - » Overall fund size based on one of the KickStart models (e.g., partial Classroom model)
 - » Maximum flexibility for schools
 - » Allocated fund dollars through a flexible discount (i.e., FTS) provides appropriate flexibility for schools to determine their individual needs and match funds to meet those unique needs

Key Concluding Points

- The Interstate universal service fund should replace the interstate CCL and USF for non-rural companies
- Universal service support should be based on fully distributed book costs
- Universal service support must be grounded in revenue neutrality upon implementation

Illustrative Example of Fund Calculations

	<u>(\$ B)</u>	<u>(\$ B)</u>
Total Federal (Joint Board) Fund		15
Interstate Component	7	
Intrastate Component	8	
 Total State Funds		<u>6</u>
 Total Core Universal Service Support		21
 Total Estimated Interstate Retail Revenues	65	
Interstate Assessment %	10.8%	
 Total Estimated Intrastate Retail Revenues	95	
Average Intrastate Assessment % (Federal)	8.4%	
Average Intrastate Assessment % (State)	6.3%	
Average Intrastate Assessment % (Total)	14.7%	